The Pakistan Credit Rating Agency Limited

Rating Report

Liberty Mills Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
10-Jul-2021	A+	A1	Stable	Maintain	-
10-Jul-2020	A+	A1	Stable	Maintain	-
12-Jul-2019	A+	A1	Stable	Maintain	-
11-Jan-2019	A+	A1	Stable	Maintain	-
09-Apr-2018	A+	A1	Stable	Maintain	-
12-Jun-2017	A+	A1	Stable	Maintain	-
14-Jun-2016	A+	A1	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Liberty Mills' ratings reflect strong business profile of the Company emanating from value added textile business and topped up with non-core income from investments. This diversity in revenue stream insulates the Company's profitability to an extent by providing a significant cushion. Liberty Mills, a family-owned textile company, operates in apparel, institutional and home textile segments. The focus of company on established niche of quality-conscious institutional buyers has led to customer concentrations and longevity of relationship with big-name clients in addition to sustained quality that helps manage the risk. The holding company structure of the entity strengthens its profile with investment book constituting ~75% of the equity base. Over the past 3 years, the company has shown an increasing trend in revenues despite COVID-19 outbreak and subsequent cross border lockdown in FY20. The increase in sales of home textile products has benefited the company and resulted in enhanced turnover. The Company's financial risk profile remains strong, characterized by moderate leveraging and in turn, strong debt-servicing ability. The Company has borrowed loans, both short term and long term in nature at concessionary rates from SBP. This keeps financing costs low and confines the Company from interest rate risk. Ratings also incorporates strong sponsor support augmented by supplementary investment portfolio.
Going forward, Liberty is currently undergoing large scale diversification with 2 upcoming Wind power projects with COD on Dec 31, 2021. Liberty is also in the process of expanding home textile business as well as setting up backward integration. To this end, 152 Acres has been purchased at Nooriabad to set up a master complex from Spinning right upto finished fabric. In the first phase, a brand new weaving unit comprising 144 Air-jet looms is being set up with related infrastructure and ancillary processes along-with Auto Coro Spinning. Phase Two would comprise additional 120 Air-jet looms with expansion in Auto Coro Spinning, if required. Processing and Printing will be set up in Phase Three. Land has already been purchased and Civil works for Weaving and Spinning Mills are in process along with Construction of Residential Colony, Masjid & Market at Nooriabad, Sindh. Plant and Machinery have been procured and are under various stages of shipments, deliveries and installations.

Liberty Group - the sponsor - intends to expand its industrial footing with a diversification philosophy. A number of medium and long-term projects are underway at group- level including (i) Pakistan Aluminum Beverage Cans Limited (ii) Pharmaceutical projects and (iii) Hydro Power projects. Continued utilization of beefed-up capacities is considered critical. Moreover, improvement in governance framework will be favorable for the ratings. Going forward, increase in business size, continuation of dividend/other income stream will be important.

Profile

Legal Structure Liberty Mills Limited (Liberty Mills) is an unlisted, public limited concern incorporated in 1964.

Background Liberty Mills commenced operations in 1964 as a private limited Company. Later, in 1969, its legal status was changed to a public, listed company. In Dec'13, the Company was delisted from the stock exchange.

Operations Liberty Mills is in the business of manufacturing and processing of textile fabrics and made-ups. It operates in two main segments: processing (dyeing and printing) and home textile. The Company generates electricity for its in-house use though captive power generation. Its manufacturing facility is located at Sindh Industrial and Trading Estate in Karachi.

Ownership

Ownership Structure Liberty Mills is the flagship company of the Liberty Group. It is owned wholly by the Mukaty Family, mainly through family members.

Stability In the absence of a group holding company and the personal relationship that exists between the sponsors, there is no formal succession plan, which poses a threat to the stability of the Company.

Business Acumen With almost four decades of experience, the Liberty Group has expertise in textile and energy sectors of Pakistan. The sponsors carry extensive diversified industrial experience.

Financial Strength Apart from presence in textile and energy, the Group also has interests in the aluminum sector. Furthermore, it has planned investments in power and pharmaceutical sectors. The sponsors have shown a willingness and ability to support the Company in times of need.

Governance

Board Structure The Board of Directors comprises of eight members of the Mukaty family. The Board is Chaired by Mr. Muhammad Ashraf who also holds the office of CEO. Absence of independent oversight indicates a need for improvement in the governance structure of the Company.

Members' Profile The Chairman, Mr. Muhammad Ashraf, brings with him over 30 years of experience in the local textile industry. Meanwhile, all Board members have significant industry related as well as diversified experience and have a long association with the Liberty Group.

Board Effectiveness Board meetings are conducted at regular intervals. However, documentation of discussion in meetings needs improvement. To ensure proper oversight, the Company has also formed two committees – Audit, and Human Resource & Remuneration – to assist the board on relevant matters.

Financial Transparency M/s Kreston Hyder Bhimji & Co. Chartered Accountants is the external auditor of the Company. They are classified by the State Bank of Pakistan in "Category A" on its panel of auditors. The auditor gave an unqualified opinion on the Company's financial statements for the year ended June 30, 2020.

Management

Organizational Structure The structure of the Company is currently divided into ten functional departments, with the Head of each department reporting directly to CEO, Mr. Muhammad Ashraf.

Management Team Mr. Muhammad Ashraf – CEO of the company is supported by a team of experienced professionals. Most of the senior management has been associated with the Company for a reasonably long period of time. Prior to joining Liberty Mills, he was also the CEO of Liberty Power Tech Limited.

Effectiveness Liberty Mills maintains adequate IT infrastructure and related controls. The Company has a comprehensive reporting system for the management to keep track of activities.

MIS Oracle based Enterprise Resource Planning (ERP) system has been deployed which provides an integrated view of business processes, facilitating comprehensive MIS reporting.

Control Environment Liberty has a well-trained quality control department. The Company is ISO 9001 certified. It also has an internal audit department that reports directly to the CEO, while it should report to the Audit Committee of the Board, to ensure effectiveness of the function.

Business Risk

Industry Dynamics The country's textile exports have witnessed 9.06% growth during the first nine months (July-March) of FY21 and remained at $11.35bln compared to $10.4bln during the same period last year. Textile group exports have witnessed an increase of 9.85% in Mar-21 as it stood at $1.35bln compared to $1.2bln during Feb21. Textile group exports have registered a growth of 30.38% year-on-year basis as it reached $1.3bln in Mar-21 compared to $1.03bln in Mar-20. COVID-19 pandemic and related lock down imposed by the governments around the globe in FY20 had its ramifications however Pakistani textile exports have been seen rebounding in 1HFY21. Most of the segments recorded incline in prices (USD terms) which is positive. The export outlook is likely to remain stable in the medium term as textile units have been operating at optimized capacity levels.

Relative Position Liberty Mills is placed among the major value-added textile exporters of Pakistan. The Company faces competition from other large players such as Yunus Textile Mills, Kohinoor Textile Mills, Gul Ahmed and Nishat Mills.

Revenues Liberty Mills' revenue is dominated by exports (9MFY21: ~97%) and witnessed a growth of ~14% YoY. The company's revenue stood at PKR 27bln (9MFY20: PKR 24bln) due to more focus towards home textile products, a higher value-added segment.

Margins The Company's gross margin has shown a decrease of ~1% in 9MFY21 (9MFY21: ~13.5%, 9MFY20: ~14.6%) mainly due to the increase in raw material (fabric) prices. The same has been translated into the deterioration of operating margin which decreased to ~7.3% (9MFY20: ~9.2%). While the net margin showed YoY improvement (9MFY21: ~9.8%, 9MFY20: ~8.2%). A dividend of PKR 565mln was received from investment in marketable securities, which beefed up other income and hence the net profit. Net profit in 9MFY21 clocked in at PKR 2,660mln (9MFY20 PKR 1,946mln).

Sustainability The Company being an export-oriented entity was impacted as its demand from export destinations had gone down due to the cross border lockdowns. Consequently, the Company was not operating at optimal capacity. However, the Company also produces bed-sheets for hospitals in home textile division, which has improved and supported overall business profile of the Company. Complete resumption of operations and demand remains to be seen. The Company's strong financial health remain key in order to withstand impact of lower demand. Going forward, Liberty Group - the sponsor - intends to expand its industrial footing with a diversification philosophy. A number of medium and long-term projects are underway at group-level including (i) Liberty Wind Power (ii) Pakistan Aluminum Beverage Cans Limited (iii) Pharmaceutical projects and (iv) Hydro Power projects.

Financial Risk

Working Capital Liberty Mills' working capital needs emanate from financing its inventory of cloth and dyes & chemicals along with managing its trade receivables. The Company's net cash cycle has decreased YoY (9MFY21: 145 days, 9MFY20: 155 days) which is backed by the decrease in receivables days. Meanwhile, the Company also have a positive borrowing cushion at trade assets level 7%. At the total asset level, the Company has maintained ample room to borrow (9MFY21: 36%, 9MFY20: 36%).

Coverages Due to higher short term borrowing, the finance cost increased (9MFY21: PKR 673mln, 9MFY20: 457mln). Consequently, the Company's coverages deteriorated though remained strong (Interest coverage: 9MFY21: 2.9x, 9MFY20: 7.9x; Debt coverage: 9MFY21: 2.4x, 9MFY20: 5.9x).

Capitalization Liberty Mills maintains a moderately leveraged capital structure while leveraging has increased YoY (9MFY21: ~51%, 9MFY20: ~49%). This was mainly owing to higher short-term borrowing (9MFY21: ~PKR 18.9bln, 9MFY20: ~PKR 16.5bln). Major portion of borrowings has been availed at the SBP's concessionary rates.

The Pakistan Credit Rating Agency Limited

Liberty Mills Limited Composite	Mar-21 9M	Jun-20 12M	Jun-19 12M	Jun-18 12M
A BALANCE SHEET				
1 Non-Current Assets	8,042	5,830	5,394	4,550
2 Investments	11,576	10,738	8,052	6,078
3 Related Party Exposure	5,894	5,864	1,937	1,447
4 Current Assets	27,860	23,657	19,082	12,258
a Inventories	*14,800*	*11,284*	*9,301*	*6,139*
b Trade Receivables	*5,608*	*3,770*	*6,037*	*3,376*
5 Total Assets	53,371	46,088	34,465	24,333
6 Current Liabilities	6,097	4,458	3,120	2,416
a Trade Payables	*3,994*	*2,852*	*2,045*	*1,808*
7 Borrowings	22,385	20,021	13,501	7,702
8 Related Party Exposure	1,659	1,691	225	-
9 Non-Current Liabilities	51	51	-	-
10 Net Assets	23,179	19,868	17,618	14,215
11 Shareholders' Equity	23,179	19,868	17,618	14,215
B INCOME STATEMENT				
1 Sales	27,058	28,316	26,358	16,137
a Cost of Good Sold	*(23,418)*	*(23,980)*	*(21,517)*	*(13,874)*
2 Gross Profit	3,640	4,337	4,841	2,263
a Operating Expenses	(1,654)	(1,923)	(1,695)	(1,121)
3 Operating Profit	1,986	2,414	3,146	1,143
a Non Operating Income or (Expense)	*1,903*	*410*	*937*	*918*
4 Profit or (Loss) before Interest and Tax	3,889	2,824	4,083	2,061
a Total Finance Cost	*(673)*	*(608)*	*(342)*	*(179)*
b Taxation	*(556)*	*(349)*	*(333)*	*(230)*
6 Net Income Or (Loss)	2,660	1,867	3,408	1,652
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*1,469*	*2,373*	*4,322*	*1,655*
b Net Cash from Operating Activities before Working Capital Changes	*1,353*	*2,398*	*4,323*	*1,933*
c Changes in Working Capital	*(2,905)*	*(3,896)*	*(5,893)*	*(1,868)*
1 Net Cash provided by Operating Activities	(1,552)	(1,498)	(1,570)	65
2 Net Cash (Used in) or Available From Investing Activities	(475)	(8,005)	(3,675)	(1,444)
3 Net Cash (Used in) or Available From Financing Activities	746	797	6,025	2,066
4 Net Cash generated or (Used) during the period	(1,281)	(8,706)	780	688
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	27.4%	7.4%	63.3%	5.1%
b Gross Profit Margin	13.5%	15.3%	18.4%	14.0%
c Net Profit Margin	9.8%	6.6%	12.9%	10.2%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	-5.3%	-5.4%	-6.0%	-1.3%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/S*	16.4%	10.8%	22.7%	12.9%
2 Working Capital Management				
a Gross Working Capital (Average Days)	179	196	172	179
b Net Working Capital (Average Days)	145	164	145	149
c Current Ratio (Current Assets / Current Liabilities)	4.6	5.3	6.1	5.1
3 Coverages				
a EBITDA / Finance Cost	3.5	6.4	18.5	13.2
b FCFO / Finance Cost+CMLTB+Excess STB	2.4	3.9	11.3	6.4
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	4.0	2.3	0.5	0.8
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	50.9%	52.2%	43.8%	35.1%
b Interest or Markup Payable (Days)	65.5	102.9	109.4	79.7
c Entity Average Borrowing Rate	3.0%	2.7%	2.4%	2.1%

Credit Rating

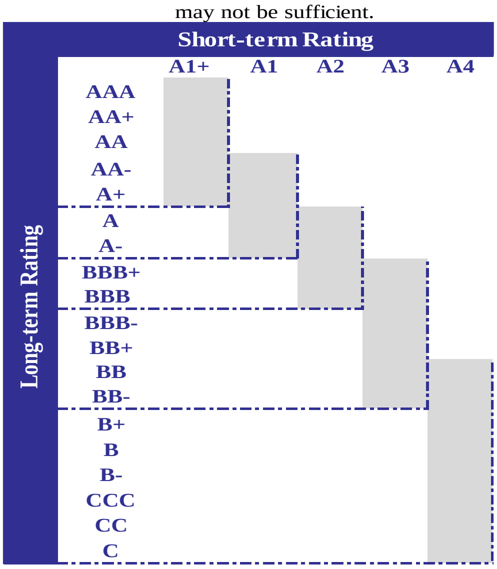
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long-term Rating

Scale	Definition
AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+ AA AA-	**Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ A A-	**High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ BBB BBB-	**Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BB+ BB BB-	**Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ B B-	**High credit risk.** A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
CCC CC C	**Very high credit risk.** Substantial credit risk "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default.
D	Obligations are currently in default.

Short-term Rating

Scale	Definition
A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



**The correlation shown is indicative and, in certain cases, may not hold.*

Outlook (Stable, Positive, Negative, Developing) Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.

Rating Watch Alerts to the possibility of a rating change subsequent to, or, in anticipation of some material identifiable event with indeterminable rating implications. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating watch may accompany rating outlook of the respective opinion.

Suspension It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn A rating is withdrawn on a) termination of rating mandate, b) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) PACRA finds it impractical to surveill the opinion due to lack of requisite information.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

Entities
a) Broker Entity Rating
b) Corporate Rating
c) Financial Institution Rating
d) Holding Company Rating
e) Independent Power Producer Rating
f) Microfinance Institution Rating
g) Non-Banking Finance Companies (NBFCs) Rating

Instruments
a) Basel III Compliant Debt Instrument Rating
b) Debt Instrument Rating
c) Sukuk Rating

Regulatory and Supplementary Disclosure

(Credit Rating Companies Regulations,2016)

Rating Team Statements

(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) **Conflict of Interest**

i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term "family members" shall include only those family members who are dependent on the analyst and members of the rating committee

Restrictions

(3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
(4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
(5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

Conduct of Business

(6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
(7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report.
(8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
(9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
(11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

Independence & Conflict of interest

(12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA´s opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
(13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers' associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
(14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
(15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
(16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst's area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
(17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

Monitoring and review

(18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 18-(a)
(19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)
(20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)
(21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)

Probability of Default

(22) PACRA´s Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA´s transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA´s Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past | Chapter III | 14-(f-VII)

Proprietary Information